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OPEN MEETING ITEM

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MEMORANDUM

Arizona Corporation Commission
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AZ CORP COMMISSION

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DOCUMENT CONTROL

TO: THE COMMISSION

FROM: Utilities Division

DATE: October 19, 1998

RE: IN THE MATTER OF THE COMMISSION EXAMINATION OF LOCAL DISTRIBUTION COMPANY PURCHASED GAS ADJUSTOR MECHANISMS (DOCKET NO. G-00000C-98-0568)

In recent years, prices in natural gas markets have shown significant volatility and the Arizona Corporation Commission (Commission) has received numerous complaints from Arizona natural gas customers that their monthly natural gas bills have greatly fluctuated from month to month and year to year. To address gas cost issues, the Commission, in its decision on a recent Southwest Gas purchased gas adjustor (PGA) filing (Decision No. 60735, March 23, 1998), ordered "that Staff establish a working group with Southwest, the other Arizona Local Distribution Companies (LDCs), and other interested parties to work together to explore possible PGA mechanism design changes, including the imposition of interest on account balances and make recommendations such that the Commission can act on those recommendations no later than November 1, 1998." This decision also indicates that issues leading to the formation of this working group include the volatility of natural gas prices, providing flexibility to LDCs in the recovery of their natural gas costs, and the possibility of developing more uniform PGA mechanisms for Arizona LDCs.

Arizona LDCs affected by this proceeding include: Bagdad Copper Market, Black Mountain Gas, Broken Bow Gas, Citizens Utilities, Duncan Rural Service Corporation, Graham County Utilities, and Southwest Gas. The PGA Design Working Group met several times and a variety of PGA and gas procurement related issues were discussed. The working group was able to come to agreement on a number of issues. The Staff Report on Purchased Gas Adjustor Mechanisms (Staff Report) incorporates a number of the working group's recommendations as well as additional Staff recommendations. The Staff recommendations are as follows:

Gas Procurement

The LDCs should pursue longer term, fixed price supply options as a viable option when they choose which gas supplies to include in their supply portfolios. To provide the LDCs with some level of assurance that they will have an opportunity to recover their prudently incurred and reasonable gas commodity costs related to fixed price contracts, while acknowledging the Commission's oversight of gas procurement activities, the Commission should adopt language such as the following:

> "As a general principle, subject to the circumstances of any specific matter: if a contract appeared to be prudent and reasonable at the time it was entered into, given market conditions and other relevant factors, the utility should be permitted an opportunity to recover the gas costs associated with that contract. However, the Commission has the right to review all LDC gas purchases on a case by case basis."

The Commission recognizes price stability as one of the goals of the natural gas procurement process.

PGA Mechanism

The banded 12-month rolling average mechanism, as described in Staff's report, should be adopted.

The bank balance thresholds should be set as follows:

Black Mountain Gas - Cave Creek Division	$180,000
Black Mountain Gas - Page Division	$60,000
Broken Bow Gas	$120,000
Citizens Utilities - Northern Arizona Gas Division	$4,200,000
Citizens Utilities - Santa Cruz Division	$250,000
Copper Market	$7,500
Duncan Rural Services	$35,000
Graham County Utilities	$150,000
Southwest Gas	$22,400,000

If there is a significant change in the number of therms sold annually by an LDC, it may be necessary to adjust the bank balance thresholds. If such a situation arises, the LDC or Staff may initiate Commission review of the need to adjust the threshold.

When the bank balance is exceeded, the following procedure should be followed:

"The utility must either:

1. File for a PGA rate adjustment within 45 days of the threshold being exceeded, OR
2. Contact Staff to discuss why a PGA rate adjustment is not necessary at that time.

If option 2 is chosen, the Company should immediately contact Staff to discuss the reason(s) why a PGA rate adjustment is not necessary. If Staff agrees that a filing is not necessary, the Utilities Division Director will notify the LDC in writing of such a finding and will identify any further conditions. If the LDC does not receive such a letter within 30 days of the bank balance being exceeded, the LDC must file for a PGA rate adjustment within 45 days of the threshold being exceeded."

This filing would be expected to impose a temporary charge or credit that would be added on to the on-going rolling average cost of gas. The credit or surcharge should have a definite expiration date.

For natural gas LDCs, the PGA rate should be banded so that the new PGA rate for a month is no more than $0.07 per therm different than the PGA rate in effect during any of the preceding 12 months. To provide a similar level of flexibility to propane LDCs, recognizing the higher average price of propane, the band should be $0.12 per therm for propane LDCs, rather than $0.07 per therm.

Reporting Requirements

The Monthly PGA Report from each LDC should at a minimum contain the following:

1. Purchases - including contract number, supplier, dollars, therms, supply basin (when available), transportation costs, and name of pipeline;
2. Sales - including number of customers, dollars, and therms by customer class;
3. Exchanged Gas (Account No. 806) - including dollars and therms;
4. Credits and Debits to Bank Balance - should include a separate sheet or sheets which detail each credit and debit and show how each credit and debit was calculated;
5. PGA rolling average calculation worksheet - this calculation should include both commodity and transportation costs; and
6. Person preparing report and telephone number.

Monthly PGA Report Format:

1. Summary Sheet - see Appendix C, Exhibit A, of the Staff Report;
2. Sales Summary Sheet - see Appendix C, Exhibit B;
3. PGA rolling average calculation worksheet - see Appendix C, Exhibit C; and
4. Sheets showing credits and debits calculations.

Provision of Invoices for Monthly Purchases:

LDCs should provide a copy of all invoices for gas commodity and transportation purchases with each monthly report. LDCs should also include in each monthly report a copy of any receipts for other credits or charges to the PGA bank balance. Because of the large number of invoices Southwest Gas has, this requirement should be waived for it, but it must have the invoices available for Commission review.

Other Reporting Issues:

Filing Date - Monthly PGA Reports should be filed within 2 months of the month that the report covers. For example, the report for January 1999 should be filed by the last day of March 1999.

Price Lag in 12-month rolling average - There should be no more than 2 months from the last month reflected in the 12-month average to the month to which the PGA rate is applied. For example, the PGA rate for March 1999 should reflect gas costs for February 1998-January 1999.

The monthly PGA report should also conform to the three Exhibits, with the understanding that individual LDCs may work with Staff to include small report modifications, to meet their reporting needs.

Treatment of Existing Bank Balances

The existing PGA bank balance should be frozen at the time the new PGA mechanism is implemented. The frozen bank balance would then be eliminated through a per therm surcharge or credit set over an appropriate period of time. The PGA surcharge would automatically expire after the designated amortization period or when the combination of the remaining frozen balance and the new balance will zero out the remaining frozen balance, whichever comes sooner.

Each LDC should file for Commission approval of a rate to amortize the existing bank balance, such that the amortization rate will be approved before the new 12-month banded rolling average PGA mechanism is implemented. Because the bank balance amortization rate will be approved before the new mechanism goes into place, there will probably be 1-2 months of over or under-collections from the old PGA rate that will not be accounted for when the amortization rate is set for the existing bank balance. Any over or under-collection during this 1-2 month transition period should be accounted for by rolling it into the new bank balance for the 12-month banded rolling average PGA mechanism.

Interest on the Bank Balance

Interest should be applied to over and under-collected bank balances incurred by Arizona LDCs using the new banded 12-month rolling average PGA mechanism. The interest rate to be applied is the Federal Reserve 3-month commercial paper rate. Interest should not be applied to the existing bank balances that are to be frozen and amortized.

Implementation of the New PGA Mechanism

LDCs must file tariff pages, report formats, and other information necessary to implement the new PGA mechanism by January 31, 1999. This filing should include a plan to educate customers on the new PGA mechanism.

An important part of the implementation process will be transitioning from each LDC's currently effective PGA rate to each LDC's banded rolling average PGA rate. The design of the phase-in procedure should not be finalized until the spring of 1999, when the Commission and the LDCs will have a better idea of the relationship between each LDC's current PGA rates and each LDC's 12-month rolling average gas cost. Given that the LDCs would be filing with the Commission in the spring of 1999 to approve the amortization rate for the existing bank balance, the LDCs should also file for Commission approval of the phase-in procedures at that time.

The new PGA mechanism and resultant PGA rates should take effect beginning June 1, 1999.

Billing and Rate Design Issues

The LDCs should consider billing and rate design options that would help to address the problem of price volatility.

Southwest Gas should no longer use prorated billing when the new PGA mechanism goes into effect and rate changes should be applied to all usage on bills rendered on or after the effective date of the change. If LDCs discover additional billing issues that need to be addressed, they should work with Staff to address those issues.

Treatment of Copper Market

Copper Market must have a PGA mechanism plan in place to address the under-collected bank balance, including possibly the parent company writing off the under-collected bank balance, by July 1, 1999. Such a plan should be approved by Staff. If such a plan is in place by July 1, 1999, Copper Market will be exempted from all other requirements of this order. If such a plan is not in place by July 1, 1999, Copper Market must implement the same PGA mechanism and meet the same requirements as other Arizona LDCs under this order.

Conclusion

A complete discussion of the recommendations and the related issues is contained in the Staff Report. Staff believes that adoption of the above recommendations will address the issues of natural gas price volatility, gas cost recovery flexibility, and uniformity between PGA mechanisms. Staff recommends approval of this filing.

Ray T. Williamson

Ray T. Williamson
Acting Director
Utilities Division

RTW:BG:yxm\JA

ORIGINATOR: Robert Gray

BEFORE THE ARIZONA CORPORATION COMMISSION

JIM IRVIN
Commissioner - Chairman
RENZ D. JENNINGS
Commissioner
CARL J. KUNASEK
Commissioner

IN THE MATTER OF THE COMMISSION EXAMINATION OF LOCAL DISTRIBUTION COMPANY PURCHASED GAS ADJUSTOR MECHANISMS.

DOCKET NO. G-00000C-98-0568

DECISION NO.____________

ORDER

Open Meeting
October 27 and 28, 1998
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Bagdad Copper Market, Black Mountain Gas, Broken Bow Gas, Citizens Utilities, Duncan Rural Service Corporation, Graham County Utilities, and Southwest Gas are engaged in providing natural gas service within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission.

2. In recent years, prices in natural gas markets have shown significant volatility and the Arizona Corporation Commission (Commission) has received numerous complaints from Arizona natural gas customers that their monthly natural gas bills have greatly fluctuated from month to month and year to year.

3. To address gas cost issues, the Commission, in its decision on a recent Southwest Gas purchased gas adjustor (PGA) filing (Decision Number 60735, March 23, 1998), ordered "that Staff establish a working group with Southwest, the other Arizona Local Distribution Company (LDCs), and other interested parties to work together to explore possible PGA mechanism design changes, including the imposition of interest account balances and make recommendations such that the Commission can act on those recommendations no later than

November 1, 1998." This decision also indicated that issues leading to the formation of this working group include the volatility of natural gas prices, providing flexibility to LDCs in the recovery of their natural gas costs, and the possibility of developing more uniform PGA mechanisms for Arizona LDCs.

4. Arizona LDCs affected by this proceeding include: Bagdad Copper Market, Black Mountain Gas, Broken Bow Gas, Citizens Utilities, Duncan Rural Service Corporation, Graham County Utilities, and Southwest Gas.

5. The PGA Design Working Group met several times and a variety of PGA and gas procurement related issues were discussed. The working group was able to come to agreement on a number of issues.

6. The Staff Report on Purchased Gas Adjustor Mechanisms (Staff Report) incorporates a number of the working group's recommendations as well as additional Staff recommendations. The Staff recommendations are as follows:

7. The LDCs should pursue longer term, fixed price supply options as a viable option when they choose which gas supplies to include in their supply portfolios. To provide the LDCs with some level of assurance that they will have an opportunity to recover their prudently incurred and reasonable gas commodity costs related to fixed price contracts, while acknowledging the Commission's oversight of gas procurement activities, the Commission should adopt language such as the following:

> "As a general principle, subject to the circumstances of any specific matter: if a contract appeared to be prudent and reasonable at the time it was entered into, given market conditions and other relevant factors, the utility should be permitted an opportunity to recover the gas costs associated with that contract. However, the Commission has the right to review all LDC gas purchases on a case by case basis."

8. The Commission recognizes price stability as one of the goals of the natural gas procurement process.

9. The banded 12-month rolling average mechanism, as described in Staff's report, should be adopted.

. . .

10. The bank balance thresholds should be set as follows:

Black Mountain Gas - Cave Creek Division	$180,000
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11. When the bank balance is exceeded the following procedure should be followed:

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This filing would be expected to impose a temporary charge or credit that would be added on to the on-going rolling average cost of gas. The credit or surcharge should have a definite expiration date.

12. For natural gas LDCs, the PGA rate should be banded so that the new PGA rate for a month is no more than $0.07 per therm different than the PGA rate in effect during any of the preceding 12 months. To provide a similar level of flexibility to propane LDCs, recognizing the higher average price of propane, the band should be $0.12 per therm for propane LDCs, rather than $0.07 per therm.

13. The Monthly PGA Report from each LDC should at a minimum contain the following:

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14. The monthly PGA report should also conform to the three Exhibits, with the understanding that individual LDCs may work with Staff to include small report modifications, to meet their reporting needs.

15. The existing PGA bank balance should be frozen at the time the new PGA mechanism is implemented. The frozen bank balance would then be eliminated through a per therm surcharge or credit set over an appropriate period of time. The PGA surcharge would automatically expire after the designated amortization period or when the combination of the remaining frozen balance and the new balance will zero out the remaining frozen balance, whichever comes sooner.

16. Each LDC should file for Commission approval of a rate to amortize the existing bank balance, such that the amortization rate will be approved before the new 12-month banded rolling average PGA mechanism is implemented. Because the bank balance amortization rate will be approved before the new mechanism goes into place, there will probably be 1-2 months of over or under-collections from the old PGA rate that will not be accounted for when the amortization rate is set for the existing bank balance. Any over or under-collection during this 1-2 month transition period should be accounted for by rolling it into the new bank balance for the 12-month banded rolling average PGA mechanism.

17. Interest should be applied to over and under-collected bank balances incurred by Arizona LDCs using the new banded 12-month rolling average PGA mechanism. The interest rate to be applied is the Federal Reserve 3-month commercial paper rate. Interest should not be applied to the existing bank balances that are to be frozen and amortized.

18. LDCs must file tariff pages, report formats, and other information necessary to implement the new PGA mechanism by January 31, 1999. This filing should include a plan to educate customers on the new PGA mechanism.

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19. An important part of the implementation process will be transitioning from each LDC's currently effective PGA rate to each LDC's banded rolling average PGA rate. The design of the phase-in procedure should not be finalized until the spring of 1999, when the Commission and the LDCs will have a better idea of the relationship between each LDC's current PGA rates and each LDC's 12-month rolling average gas cost. Given that the LDCs would be filing with the Commission in the spring of 1999 to approve the amortization rate for the existing bank balance, the LDCs should also file for Commission approval of the phase-in procedures at that time.

20. The new PGA mechanism and resultant PGA rates should take effect beginning June 1, 1999.

21. The LDCs should consider billing and rate design options that would help to address the problem of price volatility.

22. Southwest Gas should no longer use prorated billing when the new PGA mechanism goes into effect and rate changes should be applied to all usage on bills rendered on or after the effective date of the change. If LDCs discover additional billing issues that need to be addressed, they should work with Staff to address those issues.

23. Copper Market must have a PGA mechanism plan in place to address the under-collected bank balance, including possibly the parent company writing off the under-collected bank balance, by July 1, 1999. Staff should approve such a plan. If such a plan is in place by July 1, 1999, Copper Market will be exempted from all other requirements of this order. If such a plan is not in place by July 1, 1999, Copper Market must implement the same PGA mechanism and meet the same requirements.

24. A complete discussion of the recommendations and the related issues is contained in the Staff Report.

25. Staff believes that adoption of the above recommendations will address the issues of natural gas price volatility, gas cost recovery flexibility, and uniformity between PGA mechanisms.

26. Staff has recommended approval of this filing.

CONCLUSIONS OF LAW

1. Bagdad Copper Market, Black Mountain Gas, Broken Bow Gas, Citizens Utilities. Duncan Rural Service Corporation, Graham County Utilities, and Southwest Gas are Arizona public service corporations within the meaning of Article XV, Section 2, of the Arizona Constitution.

2. The Commission has jurisdiction over the LDCs and over the subject matter of this docket.

3. The Commission, having reviewed the Staff Report and Staff's Memorandum, dated October 19, 1998. concludes that it is in the public interest to approve Staff's recommendations.

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ORDER

THEREFORE, IT IS ORDERED that Staff's recommendations be and hereby are approved.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

COMMISSIONER - CHAIRMAN	COMMISSIONER	COMMISSIONER

IN WITNESS WHEREOF, I, JACK ROSE, Executive Secretary of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _____day of __________________1998.

JACK ROSE
Executive Secretary

DISSENT ______________________

RW:BG:yxm\JA